

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

TOWN OF STERLING, MASSACHUSETTS

Management Letter

For the Year Ended June 30, 2011

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Board of Selectmen
Town of Sterling
Sterling, Massachusetts

In planning and performing our audit of the financial statements of the Town of Sterling as of and for the year ended June 30, 2011; in accordance with auditing standards generally accepted in the United States of America, we considered Sterling's internal accounting control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, detect or correct misstatements on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

However, during our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. We have already discussed these comments and suggestions with Town personnel. We will be pleased to discuss them in further detail and to assist you in implementing the recommendations.

The Town's written response to our comments and suggestions has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

This communication is intended solely for the information and use of the Selectboard, others within the organization, and other regulatory bodies and is not intended to be and should not be used by anyone other than these specified parties.



Scanlon & Associates, LLC
South Deerfield, Massachusetts

March 14, 2012

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

1. Risk Assessment Procedures

Management has begun to develop a Comprehensive Policies and Procedures Manual, which will help to document policies, procedures and controls over key financial transactions that have been in place and relied upon over the years.

A key component of the comprehensive Policies and Procedures Manual is the Risk Assessment Process. The financial management team within the Town should document the policies, procedures and controls over key financial transactions, which by nature are deemed more susceptible to fraud, waste or abuse. The knowledge gained through the risk assessment process will help establish relevant and effective control procedures designed to assess the risks of material misstatement at the financial statement and relevant assertion level. Specific areas which should be assessed are documented as follows:

- Cash collected at a decentralized location for items such as revolving programs
- Payroll preparation
- Compliance with procurement laws and regulations
- Inventory of Town assets, such as computer technology

The following questions should also be considered when conducting the assessment:

- What assets are susceptible to misappropriation?
- What departments receive cash receipts?
- What departments have movable inventory?
- What operations are most complex?
- How could assets be stolen?
- Are there any known internal control weaknesses that would allow misappropriations of assets to occur and remain undetected?
- How could potential misappropriation of assets be concealed?

Recommendation

Auditing standards currently in effect require auditors to consider and evaluate what the auditee is doing internally as part of an ongoing "Risk Assessment Process." Part of the assessment includes a review of available, documented policies and procedures. We recommended that the Town use the Policies and Procedures Manual to effectuate the Risk Assessment Process. The improved understanding gained by completing the Risk Assessment Process will create the opportunity to improve operations, systems and controls, and mitigate risk at the financial statement and account balance/transaction class level.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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CURRENT YEAR COMMENTS AND RECOMMENDATIONS

1. Risk Assessment Procedures (Continued)

Management's Response

We recognize that the Town should develop policies and procedures and controls over key financial transactions. We also recognize this is a large undertaking and will be developed over a multi-year process. Our first action will be to compile other community's policies in an attempt to extract the best and to avoid re-creating the wheel. After compiling the data we will assess the information and then begin to fill in the blanks pertinent to our community's needs.

2. Continuing Appropriations

The Town had a total of \$406,155 and \$504,278 for continuing appropriations at the end of Fiscal Years 2011 and 2010, respectively. Continuing appropriations generally represent unspent money articles voted at Town Meeting. We noted that the open articles date back to Fiscal Year 2008 and of the balance of \$504,278 at June 30, 2010, only \$116,604 or 23 percent was expended in Fiscal Year 2011. Balances remaining in continuing appropriations are often funded by free cash or stabilization funds. Therefore, the remaining balance represents free cash or stabilization funds, which cannot be used for other Town needs.

Recommendation

We recommend that management review the status of continuing appropriations on a periodic basis to determine if the funds and associated purposes have been substantially completed. Department heads responsible for outstanding appropriations should provide status updates on an annual basis documenting the expected completion date of open articles.

Management's Response

We agree with the recommendation of reviewing continuing appropriations. We will work to develop a standard procedure to review articles/appropriations each fall. We will request Department Heads to review items pertinent to their respective departments and respond to the Town Administrator or Accountant and provide a status report of the project and anticipated need of available funds. If the projects are completed, the available amounts will be presented to the Board of Selectmen and Finance Committee with options for future uses. The most recent review was completed in April 2012 and we were able to identify and release five prior year articles to be used at this May's Town Meeting.

3. General Fund Budgeting

Revenue collected in excess of budgeted amounts and appropriations that are not expended during the fiscal year and closed to fund balances contribute to the Town's free cash balance as certified by the Commonwealth of Massachusetts, Department of Revenue.

In Fiscal Year 2011, the overall general fund revenue was less than the total budgeted revenue by \$(6,361) due primarily to a "shortfall" in building permits due to the economic downturn.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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CURRENT YEAR COMMENTS AND RECOMMENDATIONS

3. General Fund Budgeting (Continued)

We noted that the expenditure line item for Insurance and Employee Benefits had a budget surplus of \$261,067 in Fiscal Year 2011. The current and past two fiscal years have had the following positive budget variance in this line item:

<u>Fiscal Year</u>	<u>Amount</u>	<u>Percentage of Line Item Expended</u>	<u>Percentage of Total General Fund Appropriations Closed</u>
2011	\$ 261,067	79%	57%
2010	270,212	79%	50%
2009	303,778	71%	57%

Recommendation

We understand the need for conservative budgeting practices, especially in a weakened economy. However, we recommend that the Town consider budgeting the Insurance and Employee Benefit appropriation line item more closely aligned with the expected amount to be expended.

Management's Response

This line item consists mostly of health insurance which will be level funded or lower in Fiscal Year 2013, although the total line item will increase slightly due to property/liabilities and Medicare increases. As of April 5, 2012 the projected Fiscal Year 2012 positive budget variance for the Insurance and Employee Benefits line item is \$57,000. This is mainly due to a one-time credit from the federal government for employers who offer early retirement health benefits. Without this credit the projected positive budget variance would be \$6,600, which is only 0.7 percent of the health insurance budget. In future years we will recommend a positive variance of at least 5 percent of the budget to allow for changes due to employee turnover and other qualifying events.

4. Deputy Collector Receivable Reconciliation

The lists of outstanding taxes from the Deputy Collector are printed by the Tax Collector on a periodic basis. However, we noted that the lists have not been reconciled to the balances maintained in the Collector's Point Software Receivable System. Timely and effective reconciliations are an integral part of an effective internal control system.

Recommendation

We recommend that outstanding lists from the Deputy Collector be reconciled to the Tax Collector's internal balances periodically, with any variances documented and resolved on a timely basis.

Management's Response

We are documenting the variances and will work with the deputy collector to reconcile them.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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CURRENT YEAR COMMENTS AND RECOMMENDATIONS

5. Payment Discounts

The Town currently pays the Worcester Regional Retirement System assessment in two payments dated July 1 and January 1. In Fiscal Year 2011, the retirement system allowed member units the option of making a single payment on July 1 and a 2.04 percent reduction in the assessment was offered as a discount. The total assessment for the Town was \$475,363, which would equate to \$9,697 in savings if the single payment option was utilized. In a period of low investment returns on bank deposits, these discounts are equivalent to an attractive rate of return.

Recommendation

We recommend that the Town consider the single payment options for the retirement assessment.

Management's Response

The Town will save \$10,895, a 1.9 percent reduction, if the total assessment is paid on July 1st. The Town should have enough funds to cover the entire payment. However, should it cause any cash flow problem, the Town is permitted to borrow from its Stabilization Fund in anticipation of revenues with the Selectmen's approval.

6. Compensatory Time

Compensatory time was abolished per Personnel Bylaw, effective June 30, 2010. Per Town Counsel, "any comp time that was lawfully accrued has to be taken or paid for by the employer." It was noted that in Fiscal Year 2011, management attempted to implement a flex time policy. Allowing an employee to accrue time and use it in a future work week violates the Town's By-Law Prohibiting Compensatory Time, whether it is designated as compensatory time or flex time. As the law surrounding personnel pay and benefits is complex, any proposed policies, although well-intentioned, which affect the employer's pay or benefits should be thoroughly investigated, and verified with Town Counsel to avoid a negative financial impact to the Town.

Recommendation

We recommend that future personnel policies be properly approved by the Personnel Board after sufficient investigation and Town Counsel approval.

Management's Response

The Town Meeting enacted changes to the Personnel By-Law in May of 2010, which bars employees from accruing compensatory time in the future. In response to inquiries by the Board of Selectmen, Town Counsel has advised the Town (opinion letter of July 19, 2011) that any Comp Time accrued by exempt and non-exempt employees prior to the Personnel By-Law redraft is owed to the employees.

In Fiscal Year 2011, the Town installed a new computerized Time Accounting System. This computerized Time Accounting System was installed in response to suggestions from the Board of Selectmen, the Finance Committee, and the Town Administrator that the Town needed a modern method to track accrued paid time off, overtime, and attendance.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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CURRENT YEAR COMMENTS AND RECOMMENDATIONS

6. Compensatory Time (Continued)

The Town spent a year installing and testing the new computerized Time Accounting System and designing and reviewing a proposed Time and Attendance policy. This policy included a "flex-time" program, which was designed to be different than compensatory time. The chief difference was that the "flex-time" allowed employees to shift hours worked only within a 2-week pay period (later changed to only within 1 week).

The Town did, prior to final enactment, forward this Town policy concerning "Time and Attendance" to Town Counsel for review. However, the Town never implemented this policy. In fact, the Town has also had Town Counsel review other Town policies.

PRIOR YEAR COMMENTS AND RECOMMENDATIONS

OTHER ITEMS

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TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

7. Procurement

The Town, in the normal course of business, purchases goods and services that are subject to the requirements of Massachusetts General Laws, Chapter 30B pertaining to procurement. In summary, Massachusetts General Laws, Chapter 30B requires that applicable purchases of \$5,000 to \$25,000 be supported by documentation that quotes were obtained by at least three vendors, and that expenditures of \$25,000 or more be subject to a formal bidding process. If the purchase is obtained through the State's bid list, documentation that the vendor and goods or services are in fact on the list should be retained. Certain expenditures are exempt from the procurement process as defined in Section 1 of Chapter 30B. Goods and services procured which are exempt from the Uniform Procurement Act should also be properly documented and adequately referenced.

We noted that the Sterling Play Area Recreation Committee (SPARC) solicited quotes in Fiscal Year 2005 for a playground equipment project. In Fiscal Year 2011, the Town is expected to purchase up to \$40,000 worth of equipment related to this 2005 quote. As the procurement for this equipment was performed over five years ago, it may have been prudent for the Town to determine if the original procurement was still effective and further, whether the prospective equipment purchases need to be procured independent of the original quotes.

The objective of the procurement statutes is to ensure that municipalities are obtaining goods and services at a favorable price and that goods and services are procured from the most responsible provider.

Recommendation

We recommend that the Town establish formal policies related to procurement. These policies should include documentation requirements and resolutions of contentious or unusual procurement issues. These policies will help promote sound business practices and provide guidance in identifying and monitoring business relationships.

Current Status

In Fiscal Year 2011, we expanded our testing of procurement-related expenditures to sixteen (16) items. In addition to the item noted above, we noted the following four (4) additional purchases in Fiscal Year 2011 where procurement laws were not properly followed.

a. Tennis Courts

The Town contracted for Tennis Court Crackseal and Repairs. The quote of the lowest responsive bidder was selected. However, the vendor's liability insurance certificate was not obtained prior to contract approval.

Management's Response

We have reviewed this file and to the extent practicable, corrected all deficiencies. Three telephone bids were solicited; we received two bids, the third bidder declined to bid. The contract was awarded for approximately \$16,000.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

7. Procurement (Continued)

a. Tennis Courts (Continued)

We acknowledge that the vendor who won the contract did not obtain liability insurance until after the contract was signed, and we have worked hard to reform our procurement procedures to avoid this type of deficiency in the future.

b. IT Consultant Contract

The Town paid \$37,540 in Fiscal Year 2011 for Information Technology – Professional Services. We could not find evidence of a contract for this professional service, nor were these services procured in Fiscal Year 2011.

Management's Response

In November 2011, the IT contract was bid in accordance with Chapter 30B of the Massachusetts General Laws. Advertisements were placed in the newspaper and Central Register. Separate sealed bids were accepted for price and non-price proposals. Two bids were received. The contract was awarded to Stillwater Computer LLC, a Massachusetts registered limited liability company, to perform all of the services listed in the "Scope of Services" at a rate of \$82 per hour. The contract has been signed.

c. Air Conditioning

The Town paid \$7,400 to a vendor for Ductless Air Conditioning for the Butterick Building. The Town did not seek three quotes for this work.

Management's Response

We acknowledge that the Department that hired this vendor cannot find documentation of seeking three quotes. We have worked hard to reform our procurement procedures to avoid this type of deficiency in the future. The Town Administrator developed and conducted a procurement seminar for all departments in 2011 and will conduct this workshop again in 2012. The Town Accountant has developed a procurement form, based on the Inspector General's web site, to guide us through the bid and documentation process.

d. Well Inspections

The Town paid a vendor \$5,890 to inspect and repair two wells. The Town Department considered each inspection as two separate events and therefore did not solicit three quotes for the work.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

7. Procurement (Continued)

e. Well Inspections (Continued)

The Town's failure to follow proper procurement practices could lead to invalid contracts and potential monetary damages. We continue to urge the Town to establish formal policies, monitor compliance, and adhere to procurement laws in the Commonwealth of Massachusetts.

Management's Responses

In this instance, the Department made a judgment call that inspection of wells and repair of wells are two separate events. When the vendor goes into the well to clean it, he may also find items to repair, causing the total price to exceed \$5,000. Therefore the auditor has advised, and we will stress to all departments, that a proactive approach be taken in future procurements. In other words, if there is a likelihood that the work could exceed \$5,000, we will seek to obtain quotes in advance of beginning the work.

At the direction of the Board of Selectmen, the Town Administrator took the following actions regarding procurement procedures during Fiscal Year 2011:

- Attended Inspector General's three-day procurement class and passed exam.
- Developed one hour "Procurement Overview" workshop.
- Taught workshop to Department Heads and again to Boards/Committees.
- Developed and distributed standard contract for Chapter 30B, Goods and Services, including required appendices.
- Developed and distributed local procurement procedures for the Town under Chapter 30B.
- Drafted Designer Selection Procedures, based on the Inspector General's model. This was adopted by Selectmen.

In Fiscal Year 2012, these additional steps have been taken:

- Procurement seminar for all departments
- Procurement form to guide us through the bid and documentation process
- Pro-active approach: seek quotes if total job could exceed \$5,000.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

8. Bank Accounts

The Town has twenty-six (26) cash and investment accounts in ten (10) different financial institutions. It was noted that the Town has one account for which interest earned is allocated between General Funds and Capital Stabilization Funds. We also noted that the Town does not maintain separate operating accounts for the Business Activities of Electric Light and Water Enterprise. As a result, the business-type activities are not credited with investment income earned on operating funds. The consolidation of cash accounts is generally preferred in order to provide a more concise cash position, ease the administration and reconciliation of cash and reduce the errors associated with transferring cash between various accounts. However, it is also important for operational purposes and accountability to maintain separate accounts over some funds, such as Stabilization Funds and Business-Type Activities.

Recommendation

We recommend that separate cash or investment accounts be maintained for each Stabilization account. A pooled investment account properly allocated to individual sub-accounts is also acceptable. We also recommend separate operating accounts for the Electric Light and Water Business-Type Activities.

Current Status

As of June 30, 2011, the number of cash and investment accounts was reduced to twenty-three (23) in eight (8) different financial institutions. We also noted that the Town's balance of cash deposits, which were not insured or separately collateralized, was reduced to \$596,963 at June 30, 2011. The Town should continue to monitor banking relationships to determine if services have been properly procured and to verify that existing bank accounts meet the expectations of management with regards to risk, liquidity and rate of return.

Recommendation

We continue to recommend separate accounts for Electric Light and Water Business-Type Activities.

Management's Response

The Town continues to monitor the number of bank accounts in order to streamline administration and reconciliation of the accounts, and to minimize errors in transferring funds among the accounts. As of April 5, 2012, the Town has 22 accounts in seven (7) institutions. This is a reduction from 26 accounts in 10 institutions in June 2009.

The Accountant maintains fund balances for all Town activities without the Treasurer maintaining separate bank accounts for each. In addition, interest may be credited to the Light and Water activities without maintaining separate bank accounts. The Treasurer and Accountant will begin crediting interest to these activities beginning January 1, 2012.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

Year Ended June 30, 2011

PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

9. GASB-54 – Fund Balance Reporting

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, *Fund Balance Reporting and Governmental Fund-Type Definitions*. The statement will have a significant impact on how future fund balances are reported in the Town's financial statements. The objective of this Standard is to enhance the usefulness of financial reporting in the governmental fund types by providing clearer and more consistent fund balance reporting among governmental entities. The Standard establishes a hierarchy of fund balance classifications based primarily on the extent to which governments are bound to observe constraints imposed upon the use of resources reported in funds.

Based upon the relative strength of the constraints that control how specific fund balance amounts can be spent, the new standard provides a hierarchy of five possible fund balance classifications:

- Non-spendable Fund Balance
- Restricted Fund Balance
- Committed Fund Balance
- Assigned Fund Balance
- Unassigned Fund Balance

Governments will be required to classify and report amounts in the appropriate fund balance classification by applying existing internal accounting policies that determine the order in which resources are to be expended. Disclosure of such policies will also be required in the Notes to the Financial Statements.

Recommendation

The requirements of GASB Number 54 are effective for the Town's Fiscal Year 2011 year-end financial statements. We recommend that the Town become familiar with the new financial reporting requirement and establish a policy denoting the order in which unrestricted resources are to be used when amounts are available for expenditure.

Current Status

The Town made the necessary changes to its 2011 financial statements to be in compliance with GASB Statement No. 54.

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PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

10. Ambulance Service Reporting

The receipt of ambulance fees decreased by \$62,043 or from \$230,490 in Fiscal Year 2009 to \$168,447 in Fiscal Year 2010. It was further noted, per an analysis of the Town's detail general ledger, that there were no ambulance billings reported in February and May 2010. The months of November 2009, January 2010 and April 2010 did not have any receipt postings in the general ledger. A subsequent test of Treasurer's receipts found that an ambulance receipt deposit was made on March 25 and the next deposit was not made until May 1.

We also noted that the Town Accountant is not provided a detail listing of the monthly billings for ledger posting. The detail listing provides additional documentation related to ambulance call volume. The ambulance receivable account is currently posted from summary totals provided by the Fire Department.

It would appear that ambulance billings are not always performed on a timely basis, and ambulance receipts are not always turned over to the Treasurer in a timely manner.

Recommendation

Ambulance receipts provide a funding source for future ambulance-related operating and capital purchases. Adequate controls over billing and receipt activity should be implemented to provide assurance that all ambulance calls are properly billed and collected.

Current Status

The Fire Department made changes to the billing procedures in 2011 resulting in an increase in ambulance fees to \$246,660 for the fiscal year ended June 30, 2011.

TOWN OF STERLING, MASSACHUSETTS

Management Letter

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PRIOR YEAR COMMENTS AND RECOMMENDATIONS – OTHER ITEMS

11. Other Prior Year Issues

The following section of the Management Letter identified two prior year comments and recommendations for improvements which are reported in a much summarized manner. We will be available to discuss these with the Selectboard in more detail to assure that there is a clear understanding of the issues and recommendations.

- **Recycling Center**

There is no definitive way to ensure that all money collected at the Recycling Center is recorded in the activity ledger and turned over to the Treasurer, or that all residents who dispose of items at the Center pay for the disposal.

Additional procedures should be implemented to ensure proper payment and turnover of recycling fees. All funds received should be turned over to the Treasurer in a timely manner.

- **Water Department Billing and Collections**

The Water Department performs the majority of the accounting tasks related to the billing and collecting of their Water activity, as well as maintaining the outstanding receivable listed.

Internal controls over this activity could be greatly enhanced by separating the billing function from the collection and accounts receivable ledger maintenance functions.

Management's Response

We are aware of these issues and continue to monitor the situations. No further action can be taken at this time without either staffing additions or structural changes to government.

NOTE:

All other prior year issues have been satisfactorily resolved.